

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0356
Use Tax—Agricultural Exemptions
Penalty—Request for Waiver
For Years 2001, 2002, 2003

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ISSUES

I. Gross Retail and Use Taxes—Agricultural exemptions

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-6; IC § 6-2.5-3-7; IC § 6-2.5-5-1; IC § 6-2.5-5-2; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-5-1(a) through 45 IAC 2.2-5-7; *Graham Creek Farms v. Indiana Department of State Revenue*, 819 N.E.2d 151 (Tax Ct., 2004)

Taxpayer protests the assessment of use tax on items obtained in retail transactions that taxpayer claims are entitled to agricultural exemptions.

II. Penalty—Request for Waiver

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2(b)

Taxpayer protests the imposition of the 10% negligence penalty and requests a waiver.

STATEMENT OF FACTS

Taxpayer owns two parcels of land in southern Indiana, purchased in 2000. Taxpayer receives rental income from the individual who actually farms the land. Because the land had been neglected for awhile, and because taxpayer wanted to turn it into productive farmland suitable for growing crops, taxpayer purchased a number of pieces of equipment to clear trees and tree limbs, dig ditches, and remove rocks so actual farming could be done. Taxpayer then purchased actual farming equipment for the tenant to use. Taxpayer remained the owner of these items, providing them to the tenant free of charge. The audit determined that all the purchases were retail transactions subject to the state's gross retail tax. However, taxpayer paid no retail tax at the point of purchase, believing all were agriculturally exempt from taxation. The audit therefore

assessed the state's consumer use tax on all the purchases. Taxpayer protested, arguing that since all the equipment was necessary to support the land's productivity as a farm, all the purchases were entitled to agricultural exemptions. Additional facts will be supplied as necessary.

I. Gross Retail and Use Taxes—Agricultural exemptions

DISCUSSION

Taxpayer protests the denial of its claim for application of the agricultural exemption to purchases connected to farming operations carried on land taxpayer rents out to another individual. Taxpayer essentially argued that the audit failed to acknowledge that taxpayer's land was a legitimate farm. The audit, however, did acknowledge that legitimate farming activities were occurring on taxpayer's land. The issue is whether taxpayer is entitled to certain agricultural exemptions based on how the farming activities are carried out.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made." Pursuant to IC § 6-2.5-2-1, a "person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state." *See also*, 45 IAC 2.2-2-1. Pursuant to IC §§ 6-2.5-3-2 through 6-2.5-3-7, an "excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction." An exemption is provided in IC § 6-2.5-3-4 if "the property was acquired in a retail transaction and the state gross retail tax" was paid at the time of purchase. Taxpayers are personally liable for the tax. (IC § 6-2.5-3-6). IC § 6-2.5-3-7 provides that a "person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana;" therefore, the presumption of taxability exists until rebutted. *See also*, 45 IAC 2.2-3-4.

The standards for sustaining a claim for agricultural exemptions for machinery and equipment can be found at IC § 6-2.5-5-1, IC § 6-2.5-5-2, and 45 IAC 2.2-5-2 through 45 IAC 2.2-5-7. IC § 6-2.5-5-2 exempts certain transactions involving particular items from the state's gross retail and use taxes if the following requirements are met: "transactions involving agricultural machinery or equipment are exempt. . . if" taxpayer "acquires it for use in conjunction with the production of food or commodities for sale" and if taxpayer is "occupationally engaged in the production of food or commodities which he sells for human or animal consumption." IC § 6-2.5-5-2. Exemptions are strictly construed against a taxpayer who asserts them as a defense against tax liabilities. *See, Graham Creek Farms v. Indiana Department of State Revenue*, 819 N.E.2d 151 at 156, and cases cited therein (Tax Ct., 2004). Even under a liberal interpretation of the agricultural exemption regulations, taxpayer's activities do not meet these statutory requirements.

45 IAC 2.2-5-1 through 45 IAC 2.2-5-7 provide definitions for the important terms in the statutes. A farmer is someone “occupationally engaged in producing food or agricultural commodities for sale. . . . Only those persons, partnerships, or corporations whose intention it is to produce such food or commodities at a profit and not those persons who intend to engage in such production for pleasure or as a hobby qualify within this definition.” 45 IAC 2.2-5-1(a).

Taxpayer rents the land out. On documents taxpayer submitted in support of its protest, taxpayer is listed as the farm’s operator, but does not receive checks for being in federal agricultural programs; the actual farmer(s) who rent and work the land receive the checks. Moreover, equipment used in pre-production, i.e., preparing the land so it can become productive, is not exempt at all, regardless of who uses it. Taxpayer’s relationship to the agricultural activities carried out on land he rents out is that of a landlord. He may have actively purchased equipment and actively prepared the land for production, but that is not an exempt use of machinery and equipment. Further, for actual crop production, the growing of corn and soybeans, taxpayer receives no money from the sale of these crops. Taxpayer receives, once a year, a lump sum rental payment from those who actually work the land. Therefore, taxpayer is not “occupationally engaged in producing food or agricultural commodities for sale.” 45 IAC 2.2-5-1(a). Therefore, the agricultural exemptions available for purchases used in agricultural production are not available to taxpayer.

FINDING

Taxpayer’s protest concerning the audit’s denial of the agricultural exemption on items purchased in connection with preparing land for crop production and for actual crop production is denied.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due because it reasonably believed it was entitled to agricultural exemptions for the purchases at issue.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person’s return, timely remit taxes held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer’s carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana’s tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish

reasonable cause by “demonstrat[ing] that it exercised ordinary business care and prudence in carrying or failing to carry out a duty giving rise to the penalty imposed. . . .” In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

Taxpayer has not set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Therefore, given the totality of all the circumstances, waiver of the penalty is not appropriate in this particular instance.

FINDING

Taxpayer’s protest concerning the proposed imposition of the 10% negligence penalty is denied.

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